

Supreme Court, U. S.
FILED

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In The
Supreme Court of the United States

October Term, 1976

No. **76-1798**

ARTHUR J. HOMANS,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE SECOND CIRCUIT**

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ARTHUR J. HOMANS,

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SECURITIES AND EXCHANGE COMMISSION,

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PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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The Petitioner, Arthur J. Homans, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit which entered an order on December 16, 1976, confirming a final judgment of permanent injunction entered against said Petitioner on September 2, 1975, issued by the United States District Court for the Southern District of New York (Tenney, District Judge) enjoining him from aiding and abetting violations of Section 5 of the Securities Act of

1933 (the Securities Act). 15 U.S.C. Sec. 77e.

OPINIONS BELOW

The opinion of the Court of Appeals affirming the decision of the District Court (Appendix A infra, pp. 1a) is reported in 546 F. 2d 1044 (2d Cir. 1976). The opinion of the District Court directing the issuance of a permanent injunction against petitioner (Appendix B infra, pp. 1b) is unreported.

JURISDICTION

The judgment of the Court of Appeals was entered on December 16, 1976. A timely petition for rehearing and request for rehearing en banc was filed on January 31, 1977, and was denied by order dated and filed on March 25, 1977 (Appendix C infra, pp. 1c). This petition for a writ of certiorari was filed within ninety days after the latter date. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

(1) Is civil liability for aiding and abetting authorized under § 5(a) of the Securities Act of 1933, 15 U.S.C. § 77e(a)?

(2) Assuming the District Court properly inferred scienter, is an injunction warranted under applicable principles of equity where there is absolutely no likelihood of future violations by the defendant?

(3) Was it error for the Circuit Court to hold that, in SEC proceedings, the issuance of an injunction for violation of the Securities Act "may be predicated upon negligence alone"?

STATUTE INVOLVED

Section 5(a) of the Securities Act of 1933, 15 U.S.C. § 77e(a), and Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b), are set forth in Appendix D, infra, pp. 1d

STATEMENT OF THE CASE

Petitioner, Arthur J. Homans, seeks review of a Circuit Court decision which affirmed a judgment of permanent injunction rendered by the District Court after a bench trial.

The Second Circuit opinion below summarizes certain of the pertinent facts as follows:

"The Securities and Exchange Commission commenced this action against appellant and seven other defendants, seeking in-

junctions for violations of the Securities Act of 1933 and the Exchange Act of 1934. The other defendants consented to the entry of permanent injunctions against them. Following a trial in the Southern District of New York, Judge Tenney found that appellant had aided and abetted his client, Universal Major Industries Corporation (U.M.I.), in selling over three million shares of unregistered stock in violation of Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, and permanently enjoined him from further violations. We affirm.

U.M.I. became a publicly held corporation in 1954, and appellant was its general counsel from 1959 through 1973. In March 1967, U.M.I. sought to raise capital to expand its petroleum exploration and development operations. To avoid the registration requirements of the Securities Act of 1933 (the Act), U.M.I. decided to engage in a private placement of debentures, exempt from registration under Section 4(2) of the Act, 15 U.S.C. § 77d(2). Appellant advised that no registration would be required for the debentures so long as the number of transferees was small, they were provided with substantial information about U.M.I. operations and they possessed sufficient expertise to evaluate that information.

Instead of complying with appellant's restrictive admonitions, the company

issued almost \$3,500,000 of its 6% convertible debentures to approximately 425 persons and \$440,000 of its 7% convertible debentures to 26 persons. Realizing that U.M.I. had transgressed the boundaries of the Section 4(2) exemption requirements, appellant instructed it to have the debentures registered with the S.E.C. U.M.I. retained attorney Edward Gedalecia to process this registration, but this was never accomplished.

Between March 1967 and February 1973, U.M.I. also issued roughly three million shares of unregistered common stock. These were used for the conversion of the debentures and the payment of interest, in lieu of cash thereon; for the purchase of interests in oil and gas properties; and in exchange for services and cash. In addition, over one-half million shares, issued to controlling shareholders, were sold by them to 134 investors. Before U.M.I.'s stock could be transferred in any of these transactions, its stock transfer agent, Continental Stock Transfer Corporation (Continental), required an opinion letter from U.M.I.'s designated counsel stating that the transfer was legal. The charges against appellant are based on the letters which he, as designated counsel, wrote in compliance with Continental's requirements.

Appellant wrote some 118 letters in connection with U.M.I. transfers of stock

to debenture holders who exercised their conversion privilege or consented to receive stock in lieu of cash interest payments, of which the following is a typical example:

I refer to the attached letter of instructions from the authorized officers of Universal dated May 13th, 1968, with reference to the issuance of common stock of Universal upon a conversion of certain outstanding debentures of Universal.

With respect to the issuance of shares in accordance with the conversion provisions of the debentures, I am enclosing herewith copy of a letter of opinion from (Gedalecia), who (is) special counsel for Universal, bearing date March 11th, 1968.

The undersigned renders no opinion as to the original sale or issuance of the debentures which are presently presented for conversion, but I rely on the opinion of (Gedalecia) to the effect that the conversion of the debentures and the issuance of the stock upon such conversion, in and of itself, does not constitute a violation of the Securities Act.

However, I call to your attention

that it will be necessary to place an appropriate investment stop on your records and to place an appropriate legend upon the face of the certificates of stock to be issued. (Emphasis added).

Each of these letters was accompanied by a letter from attorney Gedalecia to U.M.I. containing in substance, the following opinion:

In view of the fact that the debentures and the underlying stock into which they are convertible were in our opinion, sold in transactions violative of Section 5 of the Securities Act of 1933, as amended (as well as the Trust Indenture Act) the conversions at this time, as proposed, would not constitute additional violations of the Act.

Appellant also wrote 88 letters in connection with other stock transfers, which were unaccompanied by a letter from Gedalecia and in which appellant clearly stated his own opinion as to the legality of the transactions."

The unregistered securities transactions which Mr. Homans was found to have aided or abetted took place over a period of approximately six years, from March 1967 through February of 1973.

The SEC's complaint was filed on August 21, 1973. The District Court opinion of Judge Tenney, S.D.N.Y., was filed on July 14, 1975. A judgment of permanent injunction was entered on September 2, 1975.

The last action by Mr. Homans involved in this case was done nearly four and one-half years ago. In the course of these proceedings, the SEC has conceded that there is absolutely no likelihood of any future securities law violations by this defendant. Mr. Homans is a well-respected attorney, 72 years of age, who has practiced law in New York City for nearly 49 years without his integrity or practice ever having been questioned, with the exception of this proceeding.

REASONS FOR GRANTING THE WRIT

POINT I

IN ERNST & ERNST V. HOCHFELDER, 425 U.S. 185, (n.7), THIS COURT STATED THAT IT IS AN OPEN QUESTION "WHETHER CIVIL LIABILITY FOR AIDING AND ABETTING IS APPROPRIATE" UNDER THE EXCHANGE ACT. THE COURT BELOW REGARDED THAT ISSUE AS CONTROLLED BY SECOND CIRCUIT DECISIONS RENDERED PRIOR TO HOCHFELDER AND REFUSED TO RE-EXAMINE IT. THIS IS AN IMPORTANT POINT OF FEDERAL SECURITIES LAW WITH BROAD NATIONAL SIGNIFICANCE.

In its opinion the Second Circuit expressly recognized that this Court had left as an open question in Footnote 7 to the Hochfelder decision "whether civil liability for aiding and abetting is appropriate" under § 10(b) and Rule 10b-5. It conceded that the same question remains open in this Court with respect to aiding and abetting liability under § 5 of the Securities Act. But it refused to consider the § 5 aiding and abetting issue an open question in the Second Circuit, despite the pertinent Hochfelder footnote, choosing instead to regard the matter as settled in the Second Circuit beyond the need for reconsideration of three of its pre-Hochfelder decisions: SEC v.

North American Research & Development Corp., 424 F. 2d, 63 (2d Cir. 1970); SEC v. Spectrum, Ltd., 489 F. 2d 535 (2d Cir. 1973); and SEC v. Management Dynamics, Inc., 515 F. 2d 801 (2d Cir. 1975). It stated that "Hochfelder does not require us to overrule these decisions, and we decline to do so."

Petitioner asks this Court to take notice of the fact that, under the nationwide jurisdiction and broad venue provisions of the securities laws, dozens of civil actions have been commenced in recent years by the SEC and private plaintiffs seeking to impose liability under an aiding and abetting theory upon accountants, attorneys, and others who were not primary actors or co-conspirators in the acts complained of and whose involvement, like that of attorney Homans in this case, was only peripheral or "secondary".

Hochfelder teaches that an accountant (and presumably an attorney as well) cannot be held civilly liable for damages solely on the basis of a finding of professional negligence. The rationale for that holding was a strict reading of the specific language of the statute [there § 10(b)] and a reluctance on the part of this Court to extend the ambit of statutory liability beyond the scope plainly intended and contemplated by Congress.

The question of civil aiding and abetting liability under the Exchange Act expressly left open in Hochfelder is closely analogous to that of civil liability for professional negligence and perhaps broader in terms of its potential significance for cases under the securities laws.

Section 5(a)(1) makes it unlawful only for "any person, directly or indirectly, ... to sell" an unregistered and nonexempt security in interstate commerce. There is no finding in this case that petitioner "sold" any securities, directly or indirectly. Writing opinion letters is not indirect "selling" within the meaning of the statute. See, SEC v. Timetrust, 142 F.2d 744 (9th Cir. 1944), reversing 28 F. Supp. 34, 43 (N.D. Calif. 1939).

Nothing in the legislative history of Section 5 indicates any intent on the part of Congress to impose liability upon any but "primary" violators named in the Securities Act, e.g., issuers, officers and directors of issuers, underwriters, etc. Indeed, where Congress intended to impose "secondary" liability upon persons not directly or primarily engaged in the selling of securities, it did so expressly in the securities statutes See Securities Act § 15, "Liability of Controlling Persons," and 1934 Act, § 20.

With respect to criminal violations

of the securities laws, liability for "aiding and abetting" may be imposed by application of a specific federal statute, in existence when the securities laws were first enacted. 18 U.S.C. § 2 (1970). There is no such statutory authority for the imposition of civil aiding and abetting liability. Indeed, the SEC admitted in its main brief on appeal below (p. 32, n.36) that it has been lobbying unsuccessfully for more than 20 years for the passage of a civil aiding and abetting statute. In the absence of such a statute, the decision below upholding the existence of civil aiding and abetting liability without supporting Supreme Court authority constitutes an impermissible act of judicial legislation in an area where Congress has repeatedly and intentionally refused to act despite intense urging from the Commission.

We do not believe that this Court wishes to engage, or to have the lower federal courts engage, in the kind of "judicial legislation" that was required to reach the decisions rendered below. In New York Times Co. v. United States, 403, U.S. 713 (1973), this Court noted that:

"It would...be utterly inconsistent with the concept of separation of powers for this Court to use its powers of contempt to prevent be-

havior that Congress has specifically declined to prohibit." (403 U.S. at 742).

It went on to point out that the Constitution "did not provide for government by injunction in which the courts and the Executive Branch can 'make law' without regard to the action of Congress." (Ibid.)

The notion that an equitable injunction may be issued where there is no likelihood of any future violation of the statute conflicts directly with the language of § 20(b) of the 1933 Act, which authorizes the SEC to bring action only to prevent future violations.

In this action, there was absolutely no purpose to be served by an injunction against attorney Homans after the defendant corporate issuers, corporate officials and securities counsel had consented to the issuance of permanent injunctions against them. Appellant was thereafter in no position to sell any of the subject securities even if he had wanted to do so. Moreover, the SEC never alleged that there was any likelihood at all of Mr. Homans participating in any future acts in violation of § 5.

This Court further stated (403 U.S. at 745);

"When Congress specifically declines to make conduct unlawful it is not for this Court to re-decide those issues--to overrule Congress."

POINT II

UNDER CONTROLLING PRINCIPLES OF EQUITY, AN INJUNCTION AGAINST FUTURE SECURITIES LAW VIOLATIONS CANNOT BE ISSUED AT THE SEC'S REQUEST WHERE THE COMMISSION HAS FAILED TO DEMONSTRATE A REASONABLE LIKELIHOOD OF FUTURE VIOLATIONS BY THE DEFENDANT.

In the exchange of arguments before the Second Circuit below, the Commission conceded Petitioner's contention that there is in this case definitely no reasonable likelihood of future securities law violations by the defendant, an attorney with an exemplary and unblemished record of service for more than 45 years prior to the commencement of this action by the SEC.

Just as that crucial fact is not disputed, neither the SEC nor the Second Circuit questioned the dispositive principle of law in this connection. In order for a permanent injunction to be issued at its request, the Commission must establish by a preponderance of the

evidence the existence of a "reasonable expectation of future violations" by the defendant. SEC v. Culpepper, 270 F.2d 241, 250 (2d Cir. 1959); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972); Hecht v. Bowles, 321 U.S. 321, 327 (1944). Where no such "reasonable likelihood" has been demonstrated, an injunction simply cannot be issued. To do so is to violate well-established principles of equity and thus to exceed the bounds of the district court's discretion.

On the present record, it is undisputed that the record indicates no reasonable likelihood of any future violations by attorney Homans. As the Circuit Court decision below concedes, this action has been in progress for more than four years, and during the entire period of time the regional staff of the Commission (whose attorneys have known Mr. Homans professionally for many years) has not indicated even the slightest suspicion that this attorney, in his practice, might be violating the securities laws or contemplating the violation of those laws.

No application was ever made for a temporary restraining order. No request was made that the trial process (which was conducted on various dates over a period of eight months) be accelerated or expedited so that the public interest

could be protected from securities law violations in which Mr. Homans might reasonably be expected to participate.

Mr. Homans voluntarily disclosed on the record the names of the few clients for whom he continued to perform securities law services while the suit was pending and the nature of every securities opinion he rendered during that time. And he offered to make his active files on those subjects available without process for examination by the Commission's staff at any time. Over the four year period that this suit has existed, the Commission has not once asked to see a single piece of paper from Mr. Homans' files. Its staff has not displayed the slightest curiosity about whether or not Mr. Homans' practice of federal securities law has stayed within the limits of the law and prudent practice.

This action involved securities law violations by only one of the hundreds of clients Arthur Homans has represented over 49 years of practice at the bar. And the record of this case shows clearly that the actions taken by Universal Major Industries Corp. ("UMI") in violation of law were all done against the advice of Mr. Homans. If that client had followed his advice, none of the violations involved in this suit would ever have taken place. Instead of taking that advice, UMI hired another attorney

to be its "special securities law counsel", obtained from that attorney opinions that were contrary to Mr. Homans' advice, and prevailed upon Mr. Homans, as "corporate counsel", to facilitate with letters from his office the issuance of securities resulting from transactions covered by opinions from special securities law counsel.

Mr. Homans freely concedes, in retrospect, that the letters he wrote for UMI should not have been written. He described in detail to the District Court (a) efforts he had taken to educate himself on the current state of law and practice with respect to federal securities regulation and (b) new procedures adopted in his office to prevent recurrence of the practices condemned by the courts below.

It is well-established in federal jurisprudence that "the historic injunctive process was designed to deter, not to punish" and that, in deciding whether or not to grant an injunction, the District Court is "subject to principles of equitable discretion." Hecht v. Bowles, supra, 321 U.S. at 321, 327. Where there is no likelihood of future violations, the issuance of a permanent injunction is not calculated to serve any useful purpose. It is, at best, a useless act and, possibly, a purely punitive one. As this Court

pointed out in New York Times Co. supra, (403 U.S. at 744):- "it is a traditional axiom of equity that a court of equity will not do a useless thing...."

It is equally axiomatic that a District Court lacks discretion to issue an injunction for punitive purposes. On the record in this case, there is no other purpose the District Court's injunction could have served.

POINT III

IT WAS ERROR FOR THE SECOND CIRCUIT TO HOLD BELOW THAT, IN SEC PROCEEDINGS, THE ISSUANCE OF AN INJUNCTION FOR VIOLATION OF THE 1933 ACT "MAY BE PREDICATED UPON NEGLIGENCE ALONE".

In rendering its decision below, the Circuit Court was well aware of this Court's holding in Hochfelder, supra, that a civil damage action under § 10(b) may not be based upon a theory of negligence alone, absent scienter. However, it was also aware of two additional factors: (a) in Hochfelder (n.12) this Court left open the question whether a theory of negligence could support a finding of 10(b) liability in an SEC injunctive suit and (b) pre-Hochfelder decisions of the Second Circuit hold "that in SEC proceedings seeking equitable

relief, a cause of action may be predicated upon negligence alone, and scienter is not required," citing: SEC v. Management Dynamics, Inc., supra; SEC v. Spectrum, Ltd., supra; SEC v. North American Research & Development Corp., supra. The Circuit Court also noted, however, that its holding on that point was in conflict with decisions in at least two other circuits, citing as examples: SEC v. Coffey, 493 F.2d 1304, 1316, no.30 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); SEC v. National Student Marketing Corp., 402 F. Supp. 641, 648-650 (D.D.C. 1975).

In substance, the Second Circuit simply refused, as it did on the issue of civil aiding and abetting, to reconsider its prior holdings in light of the footnotes in Hochfelder and thus passed both issues on to this Court for resolution of any conflicts between its decisions and the views of this Court or other circuits on the questions at issue.

The issue of "negligence versus scienter" in SEC proceedings is unquestionably one of extraordinary national importance involving, apparently, a wide divergence of views among the members of the federal appellate judiciary. We respectfully submit that this Court should take the opportunity presented by this petition to resolve the present

confusion of federal law.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

OPINION OF THE COURT OF APPEALS
FOR THE SECOND CIRCUIT

1a

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 133—September Term, 1976.

(Argued October 28, 1976 Decided December 16, 1976.)

Docket No. 75-6111

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

UNIVERSAL MAJOR INDUSTRIES CORP., et al.,

Defendants,

ARTHUR J. HOMANS,

Defendant-Appellant.

Before:

LUMBARD and VAN GRAAFEILAND, *Circuit Judges,*
BONSAL, *District Judge**

Action by the Securities and Exchange Commission to enjoin violations of § 5 of the Securities Act of 1933, 15 U.S.C. § 77e.

Appeal from the order of Judge H. Tenney, United States District Court for the Southern District of New York, granting a permanent injunction against appellant.
Affirmed.

* Of the Southern District of New York, sitting by designation.

BRADLEY R. BREWER, New York, N. Y. (Brewer & Soeiro, New York, N. Y., of Counsel),
for Defendant-Appellant.

DAVID J. ROMANSKI, Assistant General Counsel
for the S.E.C., Washington, D. C. (David
Ferber, Solicitor to the Commission;
Howard B. Scherer, of Counsel), for Plain-
tiff-Appellee.

VAN GRAAFEILAND, Circuit Judge:

The Securities and Exchange Commission commenced this action against appellant and seven other defendants, seeking injunctions for violations of the Securities Act of 1933 and the Securities Act of 1934. The other defendants consented to the entry of permanent injunctions against them. Following a trial in the Southern District of New York, Judge Tenney found that appellant had aided and abetted his client, Universal Major Industries Corporation (U.M.I.), in selling over three million shares of unregistered stock in violation of Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, and permanently enjoined him from further violations. We affirm.

U.M.I. became a publicly held corporation in 1954, and appellant was its general counsel from 1959 through 1973. In March 1967, U.M.I. sought to raise capital to expand its petroleum exploration and development operations. To avoid the registration requirements of the Securities Act of 1933 (the Act), U.M.I. decided to engage in a private placement of debentures, exempt from registration under Section 4(2) of the Act, 15 U.S.C. § 77d(2). Appellant advised that no registration would be required for the debentures so long as the number of transferees was small, they were provided with substantial information about

U.M.I. operations and they possessed sufficient expertise to evaluate that information.

Instead of complying with appellant's restrictive admonitions, the company issued almost \$3,500,000 of its 6% convertible debentures to approximately 425 persons and \$440,000 of its 7% convertible debentures to 26 persons. Realizing that U.M.I. had transgressed the boundaries of the Section 4(2) exemption requirements, appellant instructed it to have the debentures registered with the S.E.C. U.M.I. retained attorney Edward Gedalecia to process this registration, but this was never accomplished.

Between March 1967 and February 1973, U.M.I. also issued roughly three million shares of unregistered common stock. These were used for the conversion of the debentures and the payment of interest, in lieu of cash thereon; for the purchase of interests in oil and gas properties; and in exchange for services and cash. In addition, over one-half million shares, issued to controlling shareholders, were sold by them to 134 investors. Before U.M.I.'s stock could be transferred in any of these transactions, its stock transfer agent, Continental Stock Transfer Corporation (Continental), required an opinion letter from U.M.I.'s designated counsel stating that the transfer was legal. The charges against appellant are based on the letters which he, as designated counsel, wrote in compliance with Continental's requirement.

Appellant wrote some 118 letters in connection with U.M.I. transfers of stock to debenture holders who exercised their conversion privilege or consented to receive stock in lieu of cash interest payments, of which the following is a typical example:

I refer to the attached letter of instructions from the authorized officers of Universal dated May 13th, 1968, with reference to the issuance of common stock of

Universal upon a conversion of certain outstanding debentures of Universal.

With respect to the issuance of shares in accordance with the conversion provisions of the debentures, I am enclosing herewith copy of a letter of opinion from (Gedalecia), who (is) special counsel for Universal, bearing date March 11th, 1968.

The undersigned renders no opinion as to the original sale or issuance of the debentures which are presently presented for conversion, but I rely on the opinion of (Gedalecia) to the effect that the conversion of the debentures and the issuance of the stock upon such conversion, in and of itself, does not constitute a violation of the Securities Act.

However, I call to your attention that it will be necessary to place an appropriate investment stop on your records and to place an appropriate legend upon the face of the certificates of stock to be issued. (Emphasis added).

Each of these letters was accompanied by a letter from attorney Gedalecia to U.M.I. containing, in substance, the following opinion:

In view of the fact that the debentures and the underlying stock into which they are convertible were in our opinion, sold in transactions violative of Section 5 of the Securities Act of 1933, as amended (as well as the Trust Indenture Act) the conversions at this time, as proposed, would not constitute additional violations of the Act.

Despite appellant's obvious attempt to avoid a personal commitment in these letters, the District Court rejected his contention that they were simply letters of transmittal.

The District Judge said that, if they were not expressions of opinion, "it is difficult to understand why such letters were written on Homans' stationery (or, indeed, why Homans, an attorney, wrote any such letters), why such letters directed the issuance of restricted and appropriately legended stock, and why such letters contained a statement indicating that Homans *relied upon* the opinion of another." The District Judge found that the letters could reasonably have been understood by their recipients as an expression of appellant's own opinion concerning the legality of the issuances which they covered, and this finding was not clearly erroneous.

Appellant also wrote 88 letters in connection with other stock transfers, which were unaccompanied by a letter from Gedalecia and in which appellant clearly stated his own opinion as to the legality of the transactions. These letters, the District Judge said, speak for themselves. We agree.

Appellant's principal argument in this Court is based upon a footnote in the recent case of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976), where the Court said:

In view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10b(5) and Rule 10b-5, we need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule, nor the elements necessary to establish such a cause of action.

Appellant construes this statement to mean that the Court feels (a) there should be no liability for aiding and abetting a Section 5 violation, or (b) if such liability may be found to exist, it must be based upon scienter, rather than negligence. We think that appellant reads more than was written.

In order to accomplish the broad remedial purposes of the Securities Acts, *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1971), there are compelling reasons to impose secondary liability in Section 5 actions. By its terms, Section 5 makes it unlawful, "directly or indirectly", to sell unregistered stock. The heart of this prohibition would be cut away if the only person covered by its provisions was the individual who actually consummated the sale. We do not believe the Supreme Court intended that those who play an indispensable role in the sale, as appellant did here, should not be subject to SEC initiated, injunctive restraint.

Our prior decisions clearly establish that injunctive relief is proper against aiders and abettors of Section 5 violations. See *SEC v. Management Dynamics, Inc.*, 515 F.2d 801 (2d Cir. 1975); *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973); *SEC v. North American Research & Development Corp.*, 424 F.2d 63 (2d Cir. 1970). *Hochfelder* does not require us to overrule these decisions, and we decline to do so.

In these same decisions, we also made it clear that in SEC proceedings seeking equitable relief, a cause of action may be predicated upon negligence alone, and scienter is not required. While this rule has not met with universal approval, see, e.g., *SEC v. Coffey*, 493 F.2d 1304, 1316 n.30 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); *SEC v. National Student Marketing Corp.*, 402 F.Supp. 641, 648-50 (D.D.C. 1975), it is nonetheless the law of this Circuit.¹

¹ Appellant argues with some plausibility that courts should not seek to eliminate negligent behavior by enjoining against it, because, by definition, negligence is inadvertent and unintended. Moreover, if the intent or knowledge required for a finding of contempt is no greater than that required for the initial violation of the statute, see *United States v. Hill*, 298 F.Supp. 1221, 1236 (D. Conn. 1969), a defendant may find himself in contempt of court for conduct which is merely inadvertent and unintended. We are sure, however, that these considerations were not overlooked by the prior panels whose holdings we follow.

Hochfelder, which was a private suit for damages, does not undermine our prior holdings. Indeed, our decision need not rest on our rejection of appellant's negligence-scienter argument, because the District Court found that appellant in some circumstances knew and in other circumstances had reason to know that his client was engaging in illegal transactions with the aid of appellant's letters and that appellant's acts were performed with knowledge or reckless disregard of the truth. This, we have held, is sufficient to establish scienter. *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973).

Appellant also contends that, before he can be held liable for aiding and abetting, there must be proof, not only that securities were offered for sale, but also that such sales were made as part of a single, definable and integrated offering. He says that, because the sales in the instant case were made as a series of "separate, isolated and individually-negotiated transactions over a period of six years", they did not meet this latter test.

The integrated offering concept sometimes is relied upon where partial exemption from registration is claimed under §§ 3(a)(9) and 3(a)(11), 15 U.S.C. § 77(a)(9) and § 77(a)(11).² See 1 Loss Securities Regulations, 577-78, 591-95 (1961); *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680, 689-90 (5th Cir. 1971). This is done to prevent the fragmentization of what is basically a single issue of stock in order that the benefit of these exemptions might be claimed. Cf. *Shaw v. United States*, 131 F.2d 476, 480 (9th Cir. 1942).

In any event, the District Court's finding that appellant acted "with knowledge or reckless disregard of the truth" removes the props from under appellant's basic argument.

² Section 3(a)(9) exempts securities exchanged by the issuer with existing security holders involving no payment or commission or similar remuneration, and Section 3(a)(11) exempts securities which are part of an exclusively intra-state offering.

It does not follow, however, that the Commission must establish the existence of an integrated offering where a Section 5 violation is claimed. The focus of inquiry in such cases is not so much upon the nature of the offering as upon the need for protection of the class of offerees; i.e., whether they have the information which a registration would disclose, or have access to it. *Gilligan Will & Co. v. SEC*, 267 F.2d 461, 466 (3d Cir. 1959). The need for this protection remains the same whether sales are concentrated in a short period of time or made as part of a series of isolated transactions. Although the size of the offering, the number and relationship of the offerees, and the manner in which the offering is made are factors which may be considered in determining whether the offering is public or private, *Hill York Corp. v. American Int'l Franchises, Inc.*, *supra*, 448 F.2d at 687-89, these are simply criteria which are helpful in arriving at the ultimate determination of whether the purchasers or offerees require the protection of the Act. *Id.* at 689; *United States v. Custer Channel Wing Corp.*, 376 F.2d 675, 678 (4th Cir.), *cert. denied*, 389 U.S. 850, *rehearing denied*, 389 U.S. 998 (1967); *Andrews v. Blue*, 489 F.2d 367, 373-74 (10th Cir. 1973).

Finally, appellant argues that the District Court abused its discretion in issuing the permanent injunction because the SEC failed to make the required showing of a reasonable likelihood that the wrong would be repeated. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972); *SEC v. Culpepper*, 270 F.2d 241, 249 (2d Cir. 1959). In support of his contention, appellant points out that he ceased his association with U.M.I. over three years ago and states that the SEC has not even suspected him of illegal activity since that time.

A District Judge is vested with a wide discretion when an injunction is sought to prevent future violations of the securities laws, *SEC v. Manor Nursing Centers, Inc.*, *supra*,

458 F.2d at 1100, and "cessation of illegal activity does not *ipso facto* justify the denial of an injunction." *SEC v. Management Dynamics, Inc.*, *supra*, 515 F.2d at 807. The factors which he may consider include the likelihood of future violations, the degree of scienter involved, the sincerity of defendant's assurances against future violations, the isolated or recurrent nature of the infraction, defendant's recognition of the wrongful nature of his conduct, and the likelihood, because of defendant's professional occupation, that future violations might occur. *SEC v. Management Dynamics, Inc.*, *supra*, 515 F.2d at 807; *SEC v. Spectrum, Ltd.*, *supra*, 489 F.2d at 542; *SEC v. Manor Nursing Centers, Inc.*, *supra*, 458 F.2d at 1101-02. On the basis of these criteria, we find ample support for Judge Tenney's conclusion that appellant should be permanently enjoined from doing business while he is in violation of SEC rules.

The judgment is affirmed.

APPENDIX B

OPINION OF THE DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
(TENNEY, DISTRICT JUDGE)

1b

Opinion of Hon. Charles H. Tenney, D.J.
Dated July 11, 1975

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
SECURITIES AND EXCHANGE COMMISSION :

Plaintiff, :

-against- :

UNIVERSAL MAJOR INDUSTRIES CORP. :
JAMES G. DUNCAN :
TRANSAMERICAN PETROLEUM CORPORATION :
ROY M. HORSEY :
BANNER OIL AND GAS FUNDS, INC. :
IAN McCARTNEY :
ARTHUR J. HOMANS :
EDWARD G. GEDALECIA :

Defendants. :

-----X
73 Civ. 3626 (CHT)
OPINION

TENNEY, J.

This action for injunctive relief, tried to the Court, involves the liability of an attorney, Arthur J. Homans, for aiding and abetting his client's violation of Section 5 of the Securities Act of 1933 ("the Securities Act"), 15 U.S.C. § 77e.

The Securities and Exchange Commission ("S.E.C.") brought the instant action for preliminary and permanent injunctive relief against the defendant Homans and seven other defendants (three corporations and four other individuals) 1/ for violation of Section 5 of the Securities Act, and against four of those defendants, 2/ not including defendant Homans, for violation of the anti-fraud provision of that statute, 15 U.S.C. § 77q(a), and Section 10(b) of the Securities Exchange Act of 1934 ("the Exchange Act"), 15 U.S.C. § 78j(b). Seven of the defendants named in the complaint consented to the entry of permanent injunctions against them. The trial 3/ of this matter therefore involved only that portion of the complaint directed to defendant Homans, who was an attorney for the defendant Universal Major Industries Corp. ("UMI") during the relevant period.

The pertinent portions of the complaint allege that Homans has been engaged, is engaged, and will, unless enjoined, continue to engage in acts and practices which constitute and aid and abet violations of Section 5(a) and (c) of the Securities Act (Complaint ¶ 1). More specifically, it is alleged that, beginning in September 1967 and extending into February 1973, the common stock of UMI was sold or transferred to the public in large

quantities, although no registration statement had become effective (Complaint ¶¶ 14, 16), and that these sales were carried out by making use of the means and instruments of transportation or communication in interstate commerce and of the mails (Complaint ¶ 15). The complaint further alleges that:

"17. All unregistered common stock of UMI was issued in conjunction with various opinions of counsel as to the legality of the transactions. The opinions were rendered by the defendant Homans and the [firm to which Edward G. Gedalecia, another defendant named in the suit, belonged].... Each such opinion of counsel rendered by Homans or [Gedalecia's] firm represented that the issuance of UMI common stock to which the opinion pertained was exempt from registration under the Securities Act pursuant to either Section 3(a)(9) or 4(2). In fact, the aforementioned offers, sales, and delivery after sales of UMI securities were not exempt under Section 3(a)(9) or 4(2), or any other section of the Securities Act, which fact the defendants Homans and Gedalecia knew, or in the exercise of reasonable care should have known."

After an unsuccessful motion to dismiss the complaint, the Court proceeded to take evidence regarding the allegations directed to Homans. As the hearing progressed, and as confirmed by the S.E.C. after trial,^{4/} Homans' liability under the Securities Act is now limited to the claim that he aided and abetted others in violating the Act by having written 206 letters which asserted directly or indirectly that the issuance and sale from September 1967 through February 1973 of over 3 million shares of UMI common stock to over 600 persons was exempt under either Sections 3(a)(9), 4(1) or 4(2) of the Securities Act, when he knew or should have known that UMI was engaged in a public offering and distribution of its securities for which a registration statement should have been filed.

Homans contests liability on a multiplicity of grounds. In particular, he claims that there was no need to file a registration statement with respect to the securities in question because the sales were "private transactions."^{5/} Second, he argues that, even if the securities in question should have been registered, his activities could not be classified as aiding and abetting a violation of Section 5 of the Securities Act since he had no knowledge and could not have reasonably known that his letters--which he claims were not "opinion" letters--

would be used in furtherance of an unlawful scheme. Additionally, Homans argues that issuance of a permanent injunction, in light of the facts and circumstances of the case and in view of the potential damage to his professional career, would be an abuse of discretion.

The following constitute this Court's findings of fact and conclusions of law:

A. Background Facts

1. UMI

The corporation whose common stock was allegedly distributed in violation of the registration requirements of the Securities Act--UMI ^{6/}--is a Nevada corporation with its principal place of business in New York. From 1959 through August 1966, UMI was controlled by Leonard Ashbach. In August 1966, James G. Duncan conveyed all of his interest in a corporation known as Duncan Oil and Chemical Corporation to UMI, in exchange for which he received UMI stock. As a result of this transaction, both Duncan and Ashbach became the controlling shareholders of UMI, with equal voting control. Duncan Oil and Chemical Corporation, then engaged in exploration for oil and gas, acquisition of acreage under lease, and drilling and operation of wells, became a UMI subsidiary.

In March 1967, owing to a dispute between Ashbach and Duncan, Ashbach relinquished his equity in UMI to a group of individuals headed by Roy M. Horsey ("the Horsey group"). From that date until May 1968, the Horsey group was engaged in the day-to-day management of the corporation. From May 1968 and thereafter, daily management of the corporation was lodged in Duncan.

2. Homans' relation with UMI

Homans first became associated with UMI in 1959, around the time Ashbach--who had known Homans since 1944--became its controlling shareholder. Homans' position at that time was general or corporate counsel to UMI. In that capacity, he acted as an advisor to the corporation in both matters of general corporate and securities law. He continued in that capacity when, in 1966, Duncan purchased a one-half controlling interest in UMI and into and past March 1967, when his friend, Ashbach, terminated his relationship with the corporation.

It was not until October 1967 that Homans claims that his relationship with UMI materially changed. It was in that month, according to Homans, that UMI decided to retain special securities counsel. He claims that he was instructed that, from then on, he (Homans) was to perform legal services for the

corporation as corporate counsel only and that all securities work would henceforth be left to Gedalecia. 7/ Homans also claims that he was instructed that any reimbursement for securities work he might occasionally be asked to do would be rendered separately, on a per diem basis. In fact, he never received any per diem reimbursement for services rendered in connection with UMI's securities activities. Finally, he contends that the simultaneous decision of the Board to move their corporate offices to Gedalecia's firm was connected with the decision to retain Gedalecia as securities counsel.

The minutes of the meeting of the Board of Directors of October 26, 1967 (Def. Exh.E) suggest a different explanation of the events. It appears that Gedalecia and his firm were retained, at least initially, "to undertake the filing of a registration statement on behalf of the Corporation with the Securities and Exchange Commission...." (Id. at p. 2). Moreover, the real reason that UMI decided to move its corporate offices to Gedalecia's office was that UMI's rent payments for the office which it then maintained were in arrears. (Id. at p. 6). The move to Gedalecia's office was viewed as "temporary", to last until the registration statement had been filed and until UMI had found "permanent" offices. (Id. at p. 6). The minutes make no

mention of the fact that Homans was thereafter to refrain from advising UMI on securities matters. In view of the activities in which Homans thereafter engaged, see discussion Part C infra, it is probable that the minutes reflect the true state of affairs. However, inasmuch as Homans' liability is based not upon his title, but upon the acts which he performed, see discussion Part D-2 infra, the Court need not decide whether Homans' explanation is accurate.

In any event, Homans continued to work for UMI until January 15, 1973, with the exception of a short hiatus (July through November, 1972).

It should also be noted that, from August 1970 until October 5, 1971, Homans served as Secretary on UMI's Board of Directors. However, his liability under the Securities Act is based upon his activities as an attorney for UMI, and not upon the fact that he served on the Board.

B. The Securities Transactions

1. Description

During the relevant period, UMI's capital structure was composed of three tiers: (1) 6% convertible debentures; (2) 7% convertible debentures; and (3)

common stock. No registration statement was ever filed with respect to either debenture issue. In March 1971, UMI filed a registration statement covering the issuance of 1,921,000 shares of UMI common stock; however, that statement never became effective. 8/

Between April 1967 and December 1968, UMI issued approximately \$3,500,000 of its 6% convertible debentures to approximately 425 transferees. Between November 1966 and November 1968, UMI issued approximately \$440,000 of its 7% convertible debentures to approximately 26 transferees. These particular transactions are not directly at issue in this suit; however, they form the basis for some of the allegations directed to Homans.

The securities transactions which Homans is alleged to have aided and abetted in violation of Section 5 of the Act are: (1) issuances of common stock by UMI upon conversion of the 6% and 7% debentures; (2) issuances of common stock by UMI for interest on the 6% and 7% debentures; (3) issuances of common stock by UMI in exchange for cash, interests in oil and gas properties, or services; (4) transfers of UMI common stock by Roy M. Horsey; and (5) transfers of UMI common stock by Duncan and by Transamerican Petroleum Corporation ("Transamerican"), a corporation wholly owned by Duncan. The approxi-

mate number of shares involved are set forth in the margin. 9/

2. Transferees

Although it is likely that UMI stock was offered to persons and entities other than those which actually received the stock, 10/ Homans claims that, while he was connected with UMI, he had no knowledge of any such offers. We turn, then, to a discussion of those who actually received UMI common stock as a result of the types of transactions described above.

There is no question that some of those who received UMI common stock during the relevant period were "insiders", e.g., members of UMI's management and/or controlling stockholders. However, transfers were also made to persons with only the most tangential connection to UMI or with no connection at all.

Two transferees testified at trial. The first, Faust Nardone, purchased 5,000 shares of unregistered UMI common stock from Duncan on January 4, 1971. At the time of his purchase, he was employed by the Board of Education of the City of New York as a carpenter foreman. He had only a slight connection with UMI. 11/ The second transferee, Georg Andersen, an architectural designer, purchased (with

his wife) 1,500 shares of UMI common stock on July 22, 1971. He, too, had only the most tenuous connection with UMI, 12/ but became interested in the company after talking with his neighbor, Ian McCartney, a UMI employee.

Homans himself testified as to the identify of a great many of the persons and entities which received UMI common stock during the relevant period. 13/ He testified that, in addition to the transfers made to members of UMI's management and their immediate families, transfers were also made to business associates of members of management, personal acquaintances of members of management, persons who held fractional interests in wells in which UMI or members of UMI's management also held interests, and persons and entities which had performed services for the corporation.

The transferees' knowledge of the securities world and of UMI's business varied. Obviously, those transferees who were members of management, those transferees for whom management made the investment decision, and those other transferees who were generally acquainted with the ups and downs of securities investments and who otherwise had easy access to UMI management stood the best chance of understanding the nature of their investments in UMI and the relative risks

involved. However, there were others whose knowledge and understanding of what was involved could only be characterized as minimal.

Thus, Mr. Nardone, although concededly an investor in high risk securities and a person who followed the stock market, was not a "sophisticated" investor. 14/ He testified that he approached UMI (or, more correctly, Mr. Duncan) for the purpose of investing in UMI unregistered common stock after attending a UMI stockholders meeting at which "Mr. Duncan had charts, and put them up on the bulletin board and he started showing all the projections, and all the projections showed up and up and up." 15/ Nardone testified that he had no understanding of the charts. 16/ He signed an "investment letter" which he did not understand. 17/ Mr. Andersen testified that, although Mr. McCartney, who introduced him to UMI, elaborated on the company's affairs, Andersen did not fully understand him. 18/ He too testified that he did not understand the import of the "Investment letter" which he was asked to sign. Indeed, he did not recollect whether there were any restrictions on the securities which he had purchased. 19/

It is not at all clear from the record what kind of information was made known to a prospective transferee or what kind

of information would have been made known to one had he inquired. Certainly, there was no proof that there was any uniform attempt to present transferees with the sort of information which UMI would have had to have made available had the corporation registered its securities. 20/

C. Homans' Activities in Connection with the Securities Transactions

1. The Letters

The S.E.C. alleges that Homans wrote a total of 206 "opinion letters" in connection with the five types of transactions described in Part B-1 supra, and that these letters were instrumental in furthering the issuance and sale of over 3,000,000 shares of UMI common stock to over 600 transferees. Homans, on the other hand, contends that the letters, which he concededly wrote, were nothing more than cover letters or "transmittal letters."

For purposes of convenience, the letters can be classified as falling into one of two categories: Form-1 letters and Form-2 letters.

According to Homans, Form-1 letters, used in reference to the issuances of common stock upon conversion of debentures and in lieu of cash interest

upon the debentures, are on their face "transmittal letters". Such letters were written under Homans' letterhead and were addressed to UMI's transfer agent. Exhibit 3 is a typical Form-1 letter. It reads:

"I refer to the attached letter of instructions from the authorized officers of Universal dated May 13th, 1968, with reference to the issuance of common stock of Universal upon a conversion of certain outstanding debentures of Universal.

"With respect to the issuance of shares in accordance with the conversion provisions of the debentures, I am enclosing herewith copy of a letter of opinion from (Gedalecia) who (is) special counsel for Universal, bearing date March 11th, 1968.

"The undersigned renders no opinion as to the original sale or issuance of the debentures which are presently presented for conversion, but I rely on the opinion of (Gedalecia) to the effect that the conversion of the debentures and the issuance of the stock upon such conversion, in and of itself, does not constitute a violation of the Securities Act.

"However, I call to your attention

that it will be necessary to place an appropriate investment stop on your records and to place an appropriate legend upon the face of the certificates of stock to be issued." (Emphasis added)

The Form-1 letters always accompanied a letter from Gedalecia or his firm addressed to UMI. Exhibit 3A, typical of Gedalecia's letters, reads:

"This refers to your question respecting the conversion into stock of outstanding debentures of Universal in accordance with the provisions contained therein.

"In view of the fact that the debentures and the underlying stock into which they are convertible were in our opinion, sold in transactions violative of Section 5 of the Securities Act of 1933, as amended (as well as the Trust Indenture Act) the conversions at this time, as proposed, would not constitute additional violations of the Act."

See also Exhs. 4, 4A, 5 5A;

The other type of letter, used in reference to all of the other transactions, was also typed under Homans' letterhead and addressed to UMI's transfer agent.

According to Homans, these Form-2 letters were also "transmittal letters" in the sense that, although they ostensibly contained an opinion from Homans, they were really mere codifications of Gedalecia's opinion, relayed to Homans either by Gedalecia or by a member of UMI management after speaking with Gedalecia. Exhibit 6, typical of such Form-2 letters, reads:

"Reference is made to the accompanying letter dated January 30, 1970, from Universal Major Industries Corp., instructing you to issue a total of 15,750 shares of the common stock of Universal to the persons designated in said letter.

I am counsel to Universal and I submit the following opinion to you. I have examined the minute books of the corporation and other relevant documents and on the basis of the foregoing, it is my opinion that the issuance of these 15,750 shares have been duly approved as required by law; and that all appropriate action necessary for the issuance of such shares has been taken. It is therefore my opinion that such shares, when issued, will be regularly issued, fully paid and non-assessable.

"You are further advised that

these shares have not been registered under the Securities Act of 1933. Therefore, you are requested to place an appropriate notation to the effect that further transfer of these shares is restricted except under applicable rules and regulations of the Securities and Exchange Commission. You are further requested to place an appropriate legend on the certificates themselves to the same effect.

"You are further advised that the corporation has received from the persons named so called 'investment letters' in form approved by the undersigned, to the effect that they are acquiring the said shares for investment only and not for public sale or distribution.

"It is my opinion therefore that the issuance of such shares is not in violation of the Securities Act of 1933, nor of the rules and regulations of the Securities and Exchange Commission." (Emphasis added)

The "Form-2" letters, it should be noted, did not contain any enclosures from Gedalecia. See also Exh. 7A

To classify either form of letter as

a "transmittal letter" is an understatement. The "Form-2" letters speak for themselves. The fact that such letters were purportedly written under Gedalecia's direction does not negate the conclusion that any third party receiving such a letter would have reasonably concluded that Homans, as an attorney, was expressing his own opinion as to the legality under the Act of a particular issuance or transfer of stock.

The Form 1 letters, similarly, could reasonably have been understood as expressing an opinion, albeit one made "in reliance upon" another's opinion, as to the legality of the issuances which they covered. If, as Homans contends, such letters were merely intended to serve as "transmittal letters", it is difficult to understand why such letters were written on Homans' stationery (or, indeed, why Homans, an attorney, wrote any such letters), why such letters directed the issuance of restricted and appropriately legended stock, and why such letters contained a statement indicating that Homans relied upon the opinion of another.

2. The Claimed Exemptions

Of the total of 206 letters which Homans admittedly wrote, either on his own or in reliance upon Gedalecia, 82 of them, written between May 16, 1968

and May 1970, covered the issuance of 1.1 million shares of UMI's common stock to approximately 250 debentureholders for conversion of their 6% and 7% debentures. Those 82 letters were of the Form-1 type, i.e., Homans indicated that he was relying upon an opinion of Gedalecia, contained in a letter to UMI dated March 11, 1968. That letter, quoted supra, stated that, although the issuance of the underlying debentures was violative of the Act, the conversions and issuances upon conversion would not constitute violations of the Act. Although the March 11, 1968 Gedalecia letter does not state upon which section of the Act that conclusion was based, it appears that it was based upon Section 4(2) of the Act.
21/

Another 36 of the letters covered the issuance from about August 21, 1969 to June 18, 1971 of approximately 270,000 shares of UMI common stock to approximately 300 debentureholders in lieu of cash as interest on debentures. These letters were written between June 1969 and February 1971, and like the 82 letters discussed above, were Form-1 letters, this time based upon one of seven opinions that had been rendered by Gedalecia or his law firm. Six of the seven Gedalecia opinions relied upon Section 3(a)(9) of the Act, while the seventh relied upon Section 4(2) of the

Act.

The remaining 88 letters, all of the Form-2 variety, covered issuance of UMI common stock for cash, services and property (46 letters) and UMI common stock transferred to others by Duncan, Transamerican, and Horsey (42 letters). In the case of the former, Homans relied upon Section 4(2) of the Act; in the case of the latter, he relied upon Section 4(1) of the Act.

3. Procedure under which Homans issued the letters

Homans testified at great length as to the procedure he followed before writing any letter, whether of the Form-1 or Form-2 type, to UMI's stock transfer agent.

First, he testified that, before Gedalecia became special securities counsel for the corporation, Homans had instructed management as to the proper procedures which must be followed with respect to securities transactions involving unregistered UMI securities, transactions which he referred to as "private transactions". These instructions, which Homans called an "understanding", provided that unregistered securities could only be transferred to persons closely and intimately related to members of UMI management; that all

prospective transferees were to be furnished with whatever financial information they required; that all prospective transferees were to be screened as to their relative "sophistication"; and that in all instances, prospective transferees were to be instructed that the stock which they would receive was "restricted", unregistered stock. 22/

Second, he testified that he would never write any letter to Continental unless he had received (1) a letter from UMI authorizing the issuance or transference of the stock, (2) information indicating that the transaction was a "private" one or one involving an "exchange for working interests" and (3) a letter ("investment letter") signed by the prospective transferee indicating that the transferee was acquiring the stock for investment purposes only; that the transferee would not dispose of the shares unless and until UMI's counsel was of the opinion that they could be so disposed; that the transferee understood that the shares were unregistered; and that the transferee had been furnished "with such financial and other data relating to [UMI] and its business which [the transferee] considered necessary and advisable to enable [him] to form a decision concerning [his] acquisition." 23/ UMI's use of the term "private transaction" would indicate to Homans that the transaction was one negotiated under and in

compliance with the terms of the understanding he had with management. UMI's use of the term "exchange for working interest" also meant to Homans that the transaction was a private one: the transferee was a "partner" or "joint venturer" with UMI in a well or wells; the transferee was a "sophisticated investor", having been sufficiently "sophisticated" to have invested in oil and gas ventures for tax purposes; the transferee had approached UMI and had offered to "swap" his interest in an oil or gas well for an interest in a corporation with numerous wells and acreage; and the deal had been separately and individually negotiated as to price on a "one-shot" basis. 24/

Crediting Homans' testimony as to the procedure he followed, it should be noted that Homans never instructed management that every prospective transferee was to be provided with the sort of information that UMI would have had to divulge had it complied with Schedule A. Additionally, Homans testified that, although from time to time, he had an opportunity to meet prospective transferees and that, on other occasions, he recognized the names of transferees as persons whom he would consider "insiders", it was not his regular practice to look behind any of the representations made to him.

4. The function of Homans' letters in the distribution of UMI common stock

The conclusion that both the Form-1 and the Form-2 letters were what are commonly known as "opinion letters" is bolstered by the testimony of Joseph Lowe, a vice-president of Continental Stock Transfer Corporation ("Continental"), the company which acted as UMI's stock transfer agent during the relevant period. Lowe testified that it was Continental's practice before taking any action to require (1) a letter from UMI authorizing the issuance or transfer of stock and (2) a second letter containing an opinion from UMI's designated counsel as to the legality of the issuance or transfer. He further testified that, had Continental received a letter from Gedalecia without an accompanying letter from Homans, i.e., a Form-1 letter, it would not have issued or transferred any shares. The reason was that UMI had never formally advised Continental that it could rely upon Gedalecia's opinion.

Homans claims that he was unaware of Continental's "internal" policies. His claimed ignorance strains credulity. The very fact that Homans continued to write such letters to Continental long after Gedalecia was retained as special securities counsel 25/ belies that contention. Moreover, his testimony as to the circumstances under which he would send such letters negates his claim. As indicated earlier, he testified that he would never issue any letter to Continental unless he

had in hand an investment letter from the potential transferee, as well as information, in the form of a letter or an oral communication, to support the conclusion that the transfer was a "private transaction" or an "exchange for working interest." Additionally, he was always careful to provide in his letters that the stock transferred was to be "restricted" and appropriately legended. In other words, all of his actions were consistent with the conclusion that he had knowledge that his letters were considered opinion letters and that they were a condition precedent to the issuance or transfer of UMI common stock. Whether he had direct knowledge that his letters were likely to be used in furtherance of an unlawful distribution is a slightly different question, which the Court now addresses.

5. Homans' State of Mind

Homans contends that he had no knowledge of any illegal distributions of UMI stock and, furthermore, that, in light of all of the circumstances, he could not reasonably have concluded that such was the case. He contends that it was not until he had terminated his relationship with UMI and the S.E.C. had begun to investigate UMI's securities dealings that he discovered that UMI might in fact have been engaging in illegal distributions of its common stock.

Homans suggests that, after Gedalecia had been retained and after Duncan had taken over management of the corporation, the understanding which Homans says he had with UMI management was surreptitiously abandoned, but that, in view of his relationship with Duncan and with Gedalecia, he could not have reasonably discovered that fact earlier.

As Homans describes it, Duncan (with whom Homans did not share a close relationship) abandoned the understanding by authorizing UMI employees, e.g., McCartney, to solicit prospective transferees. Such prospective transferees, Homans now concedes, did not always have that degree of sophistication or relationship with UMI which even Homans would have considered sufficient to warrant an exemption under Section 4(2). However, because management continued to represent to him that the transfers were "private transactions" or "exchanges for working interests" and continued to forward to Homans signed "investment letters" from prospective transferees, Homans claims he had no reason to suspect that his instructions to management were not being followed. Homans further claims that it was reasonable for him to assume that Gedalecia was supervising the day-to-day implementation of his instructions since Gedalecia was purportedly expert in such matters, UMI had removed its corporate

offices to Gedalecia's office, and Homans had been directed to stay out of such matters.

In light of certain other evidence adduced at trial, however, the Court must conclude that, in some circumstances, Homans knew, and, in other circumstances, had reason to know that his client was engaging in illegal distributions of its common stock and that his letters were being used to further those distributions. To reach that conclusion, we must retrace our steps.

In March 1967, the UMI Board of Directors authorized a "private placement" of 6% convertible debentures in the face amount of \$3 million. At the time the proposal came before the Board, Homans understood that 25% of the placement was to issue to Duncan in exchange for Duncan's having transferred to UMI his interests in certain oil and gas wells. Based upon that understanding and upon other information to the effect that the remainder of the placement was to go to a limited number of individuals, Homans believed that the debentures could be distributed without filing a registration statement.

Within two weeks prior to October 27, 1967, (the date Gedalecia was retained), however, Homans learned that the 6% con-

vertible debentures were being issued to "numerous" or "substantial" numbers of persons in exchange for their fractional interests in oil and gas wells, so that it now appeared to him that the original debenture issue should have been registered. He apparently informed UMI management of his reservations and it is quite probable that the retention of Gedalecia shortly thereafter was causally connected to Homans' communication, i.e., it is probable either that management, unhappy with Homans' suggestion that the debenture issue be registered, decided to look elsewhere for advice more amenable to its objectives or that, alternatively, Homans himself requested the retention of other counsel for the specific purpose of handling the delicate matter of the debenture issue. Whatever the true facts may be, Homans was clearly on notice as of October 1967 that his client could not be trusted in matters involving the distribution of its securities.

The story does not end there. UMI continued to sell the unregistered debentures as late as December 1968 without filing a registration statement. Additionally, UMI decided that it would issue UMI common stock for conversion of, or in lieu of cash interest upon, the debentures. Homans claims that he told management he would not write an opinion authorizing issuance of common stock in those

instances and demanded that management obtain the opinion of other counsel for that purpose. 26/ Had Homans been ignorant of the fact that such distributions of common stock (based upon earlier illegal distributions of the debentures) were themselves illegal, it is difficult to understand why he would have insisted upon an opinion from other counsel. That he knew he might be held liable for aiding an illegal distribution is buttressed by the fact that, although Homans blithely issued Form-2 letters regarding the legality under the Securities Act of other transfers of UMI common stock, he specifically used the Form-1 letter when asked to communicate with Continental regarding the issuance of stock upon conversion of or in lieu of cash interest upon the debentures.

Knowing that, on at least one occasion, his client had proceeded to distribute common stock where the underlying stock transaction was itself illegal, his failure to investigate the numerous other representations made to him regarding the other transfers of common stock cannot be defended as reasonable under the circumstances. Although there is no direct proof that he had knowledge that such transactions were illegal under the Securities Act, his policy on relying upon the representations made to him without any investigation might be viewed as a calculated attempt to avoid liability based

upon such knowledge.

Additionally, the claim that Homans reasonably relied upon Gedalecia to ensure UMI's compliance with the Securities Act is undercut by the fact that the very first opportunity he had to observe Gedalecia's work revolved around the issuance of common stock upon conversion of the 6% debentures. Homans admittedly relied upon Gedalecia's "opinion" that the issuances, although not accompanied by registration, were lawful under the Act. (Exh.3). That "opinion", if that is what it can be called, provided in pertinent part that:

"In view of the fact that the debentures and the underlying stock into which they are convertible were in our opinion, sold in transactions violative of Section 5 of the Securities Act of 1933, as amended (as well as the Trust Indenture Act) the conversions at this time, as proposed, would not constitute additional violations of the Act." (Exh. 3A).

Starting from the proposition that the letter is itself a non sequitur and remembering that Homans had by this time concluded that the debentures had been issued unlawfully, so that issuance of common stock upon conversion was impossible without registration, it

cannot be said that Homans was justified in assuming that Gedalecia was competent to advise UMI and that Gedalecia was adequately supervising UMI's compliance with the Securities Act.

D. Liability

1. Illegal Distributions

Homans is charged in this injunctive proceeding with having aided and abetted others in violating Section 5 of the Act. That section provides in pertinent part:

"(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly --

(1) ... to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce ... any such security for the purpose of sale or for delivery after sale.

. . .

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of

transportation or communication in interstate commerce or of the mails to offer to sell ... through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security...."

The purpose of this section is "to protect investors by requiring registration with the Commission of certain information concerning securities offered for sale." Gilligan, Will & Co. v. S.E.C., 267 F.2d 461, 463 (2d Cir.), cert. denied, 361 U.S. 896 (1959). The sort of information which would be disclosed upon registration is set forth in Schedule A, 15 U.S.C. § 77aa.

There are certain limited instances where, in the opinion of Congress, registration is not required. Thus, Section 3 of the Act, 15 U.S.C. § 77c, lists certain classes of securities for which a registration statement need not be filed. Section 4 of the Act, 15 U.S.C. § 77d, defines in broad terms those transactions in securities which need not be accompanied by registration. Those two sections, however, are to be strictly construed, S.E.C. v. Continental Tobacco Co. of S.C. 463 F.2d 137, 155 (5th Cir. 1972). To establish a prima facie violation of Section 5, the S.E.C. must establish that (1) no registration statement covering the securities in question was in effect; (2) the securities were sold; and (3)

the sale was carried out by the use of interstate communication or transportation and the mails. Id. at 155-56. Once those elements are established, the burden shifts to the party claiming the benefit of an exemption under Sections 3 or 4 to establish that a statutory exemption was in fact available. 27/

Therefore, the first point of inquiry is to determine whether the S.E.C. has established the elements of a prima facie case. That the S.E.C. has met its burden under Section 5(a) 28/ is clear from this Court's findings of facts, Part B-1, supra. There was more than enough evidence to show that UMI common stock for which no registration statement ever became effective was sold in interstate commerce through the use of the mails. 15 U.S.C. § 77e(a). Thus, our inquiry shifts to a determination of whether those sales were exempt under Sections 3(a)(9), 4(1) or 4(2) of the Act--the sections cited by Homans either directly or indirectly in the Form-1 and Form-2 letters which he wrote to Continental.

There is little point in discussing whether any of the sales of stock were exempt from registration by virtue of Section 3(a)(9) and 4(1). In his proposed findings of fact and post-trial briefs, defendant makes little effort to establish their applicability. 29/ It

is clear that the major exemption upon which defendant relies is that contained in Section 4(2) for "transactions by an issuer not involving any public offering."

Defendant's understanding of Section 4(2) is somewhat novel. He contends that the sales of unregistered UMI common stock all fell within that section because the sales were not a part of a single, integrated public offering, but were, rather, separately negotiated private transactions. (Def. Post-Trial Memorandum of Law, p. 57). Thus, defendant spends a substantial amount of time trying to establish that the sales were not part of the same issue, 30/ and that in each instance the sale was conducted privately and the price was separately negotiated. Although it is clear that, by making this argument, defendant hopes to squeeze under the "private offering exemption", his understanding of that exemption and its relationship to Section 5 of the Acts falls far from the mark.

Although Section 4(2) does not define the meaning of the phrase "public offering", the case law defining this phrase is now rather extensive. There is, for example, the seminal case of S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953), a case with which defendant never really comes to grips in his

post-trial papers. That case and the cases which have followed make it crystal clear that it is not the manner in which a sale of unregistered securities is effected, but rather the class of persons to whom such securities are offered which determine whether the Section 4(2) exemption is available.

The issue before the Court in the Ralston Purina case was whether a particular offering of defendant's stock to key employees who had solicited 31/ such stock constituted an exempt transaction under Section 4(2). Among the "key employees" to whom defendant's stock was sold were an artist, bakeshop foreman, chow loading foreman, clerical assistant, copywriter, electrician, stock clerk, mill office clerk, order credit trainee, production trainee, stenographer, and veterinarian. *Id.* at 121. The Court concluded that:

"[T]he applicability of [the exemption] should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering." *Id.* at 125.

Thus, an offering to "executive personnel who because of their position have access

to the same kind of information that the Act would make available in the form of a registration statement" might come under the Section 4(2) exemption. *Id.* at 125-26. In other words,

"the governing fact is whether the persons to whom the offering is made are in such a position with respect to the issuer that they either actually have such information as a registration statement would have disclosed, or have access to such information." Gilligan, Will & Co. v. S.E.C. *supra*, 267 F.2d at 466.

A few additional points are in order. First, it would appear that, when deciding whether the Section 4(2) exemption is available, inquiry should be directed to the class of those who were offered stock, not simply to those who did in fact purchase the stock. S.E.C. v. Ralston Purina Co., *supra*, 346 U.S. at 125; S.E.C. v. Continental Tobacco Co. of S.C., *supra*, 463 F.2d at 161.

Second, it would appear that the mere fact that the offering is made to a limited number of persons is not dispositive.

"[T]he Ralston Purina case clearly rejected a quantity limit on the construction of the statutory

term It stated that 'the statute would seem to apply to a "public offering" whether to few or many,' 346 U.S. at page 125, 73 S.Ct. at page 984, and cited with approval the dictum that 'anything from two to infinity may serve: perhaps even one *** ' 346 U.S. 125, 73 S. Ct. 985 and note 11." Gilligan, Will & Co. v. S.E.C., supra, 267 F.2d at 467.

Third, evidence that the stock sold is thereafter "restricted" and that the purchaser has signed what is commonly known as an "investment letter" would not exempt an offering which was otherwise "public".

"Although such precautions are taken by issuers relying on the exemption of section [4(2)] to ensure that their purchasers shall not in turn distribute securities to others who might not have 'access to the kind of information which registration would disclose,' even though the initial purchasers possessed such information, 'these are only precautions [to prevent illegal distributions] and are not to be regarded as a basis for exemption

from registration.'" United States v. Custer Channel Wing Corporation, 376 F.2d 675, 679 (4th Cir.), cert. denied, 389 U.S. 850 (1967) (citation omitted; emphasis added).

Finally, the mere disclosure of the same information as would be disclosed in a registration statement to all persons offered unregistered stock would not, in the absence of showing that the offerees had the requisite relationship with the issuer and the ability to fend for themselves, suffice to form the basis for an exemption under that section. S.E.C. v. Continental Tobacco Co., of S.C., supra, 463 F.2d at 160.

Measured against the rules just cited, it must be concluded that the sales of UMI common stock covered by defendant's Form-1 and Form-2 letters should have been accompanied by an effective registration statement.

First, defendant failed to establish that UMI common stock was not offered to persons other than those who actually received it for value. Although he claims that he had no knowledge of any offers being made, the record suggests that such was the case. Without this crucial piece of information, the Court has no way of determining whether the "class of persons affected" (emphasis added) needed "the

protection of the Act." S.E.C. v. Ralston Purina Co., 346 U.S. at 125.

Second, defendant failed to establish that all of those who purchased UMI common stock or received stock for value belonged to a class of persons who could "fend" for themselves. Although some transferees, either owing to their direct relationship to UMI or to their close familial or personal relationship to members of UMI's executive management, might have had either actual or potential access to such information as a registration statement would have disclosed, the record of sales and exchanges of common stock for value. 32/ is dotted throughout with the names of persons whose relationship with UMI and whose ability to fend for themselves could only be termed "minimal".

For example, the record shows numerous transfers of common stock to persons in exchange for their fractional interests in oil and gas properties. Certainly, it cannot seriously be contended that either the class affected or the persons who actually received the stock in that case were "partners" of UMI and that each person was sufficient knowledgeable about the risks inherent in investing in UMI to be able to fend for himself. And, although Messrs. Nardone and Anderson were shareholders of UMI, directly or indirectly, their relationship to UMI--no stronger than

the relationship to the issuer of those mentioned in the Ralston Purina case--was not such as to even raise the inference that they had the kind of access to information which the Ralston Purina case requires. Nardone and Anderson may have been "atypical" UMI investors, but the very fact that they were sold UMI common stock proves that the "class of persons affected" (even if we interpret that phrase to mean "purchasers") needed the protection of the Securities Act.

Third, defendant failed to establish that those who received UMI common stock for value either obtained automatically, or had access to, the sort of information which UMI would have been compelled to disclose had it filed a registration statement. Indeed, Homans admitted that he had never instructed UMI management to make such information available. Moreover, he never offered any proof of the sort of information that was routinely made available to those who expressed an interest in purchasing the stock. The investment letters which prospective transferees were asked to sign are of little support to Homans' position. They were, first of all, "form" letters drafted by UMI, and, although those who signed them acknowledged receipt of all information which they requested, there is nothing in the record to suggest that the information, if it was furnished, corresponded in kind and quality to the

kind of information required under Schedule A.

Finally, there is the matter of the numbers of investors involved. Although the case law suggests that an offering to one person can constitute a public offering in certain circumstances, S.E.C. v. Ralston Purina Co., supra, 346 U.S. at 125 and n.11, it is conceivable that in certain circumstances, an offering to a small number of people might provide some basis for invocation of the Section 4(2) exemption. 33/ In a case such as this, however, where the transferees numbered in the hundreds, the sheer size of the distribution tends to negate the assumption that no public offering was involved.

2. Defendant's Liability

Having concluded by a preponderance of the credible evidence that there was a violation of Section 5(a) of the Securities Act in connection with the sale of UMI common stock, it must next be determined whether the S.E.C. has established by a preponderance of the evidence that Homans should be held liable as an aider and abettor.

The S.E.C. alleges that the letters written by Homans, which represented either directly (Form-2 letters) or indirectly (Form-1 letters) that "the issuance of UMI common stock to which

[the letters] pertained, was exempt from registration under the Securities Act," were erroneous, a fact which Homans either knew or in the exercise of reasonable care should have known. (Complaint ¶ 17).

Since Homans' liability is based upon his role as an aider and abettor and is grounded on the theory that he either knew or should have known of the illegal distributions of UMI stock which his letters furthered, this Court's inquiry must begin with S.E.C. v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) and S.E.C. v. Management Dynamics, Inc., et al., No. 74-1680 (2d Cir., Mar. 18, 1975), applicable to S.E.C. enforcement proceedings such as the instant case.

The Spectrum decision, a case which is in important respects analogous to the instant one, discussed the liability under Sections 5 and 17 of the Securities Act, 15 U.S.C. §§ 77e and 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), of an attorney who had issued an opinion regarding the transferability without registration of certain shares of stock. The attorney's letter, submitted to a broker-dealer, indicated that the shares could be sold pursuant to Section 4(1) of the Securities Act, which exempts from registration transactions not involving an issuer, underwriter or dealer. 15 U.S.C. § 77d(1).

It is not clear whether the attorney had been placed on notice of the fact that the transaction was one which should have been accompanied by registration, 489 F.2d at 539, nor is it clear to what extent, if any, he investigated the underlying facts before rendering his opinion, id. It seems highly probable, however, that he was aware, either at the time he issued his opinion, or shortly thereafter, that his letter could have been used to permit the sale of stock which should have been registered, id. at 539-40. Additionally, it is clear that, had he made a thorough investigation of the representations given him, i.e., had he exercised due diligence, he would have discovered that the transaction to which he was asked to give his imprimatur was one involving the unlawful distribution of unregistered shares by a statutory "underwriter".

After remanding the case to the district court for resolution of several material factual disputes bearing upon the attorney's knowledge and the degree of care he had used, the Spectrum court added that the standard which the district court had applied in assessing the attorney's liability as an aider and abettor had been incorrect. The court stated:

"In assessing liability of an aider and abettor ...the district judge

formulated a requisite standard of culpability -- actual knowledge of the improper scheme plus an intent to further that scheme -- which we find to be a sharp and unjustified departure from the negligence standard which we have repeatedly held to be sufficient in the context of an enforcement proceedings seeking equitable or prophylactic relief [Citations omitted].

"We do not believe, moreover, that imposition of a negligence standard with respect to the conduct of a secondary participant is overly strict, at least in the context of this case. The legal profession plays a unique and pivotal role in the effective implementation of the securities laws. Questions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters...." Id. at 541-42.

The Spectrum court went on to state that an attorney who prepares an opinion

letter must exercise "due diligence"; in other words, he must make a "thorough investigation" or else prohibit the utilization of his letter "in the sale of unregistered securities by a statement to that effect clearly appearing on the face of the letter." Id. at 542.

The later decision of S.E.C. v. Management Dynamics, Inc., et al., supra, No. 74-1680, has clarified the Spectrum decision. Among the issues discussed there was the propriety of issuing an injunction against a broker-dealer for aiding and abetting the distribution of unregistered securities in violation of Section 5 where there had been no finding that he "knew or should have known that his trading activity would assist...in disposing of additional unregistered shares." Id. at 2349 (slipsheet). Harking back to its decision in the Spectrum case, the court vacated the injunction, nothing:

"In Spectrum we ruled that the liability of a lawyer as an aider and abettor was to be measured by the negligence standard generally applicable to SEC injunction actions and the high degree of carelessness present there." Id. (emphasis added).

The Management Dynamics court noted that, in contradistinction to the case of the

broker-dealer, the attorney in Spectrum

"could easily have concluded that the opinion letter which he issued was likely to be used to sell unregistered securities...." Id.

Amplifying that statement, the court stated:

The crucial element of our ruling in Spectrum was that the abettor's responsibility for the alleged violation must be measured by the appropriate standard of negligence, that is, the defendant should have been able to conclude that his act was likely to be used in furtherance of illegal activity." Id. (emphasis added).

The question before this Court, therefore, is whether it is more probable than not that Homans knew, or would have known had he exercised due diligence, that his letters were likely to be used in furtherance of the illegal distribution of unregistered shares of UMI common stock.

It is clear from this Court's findings of fact that Homans' Form-1 and Form-2 letters were instrumental in furthering the distribution of UMI's unregistered stock and that Homans was well aware of this fact. (Part C-1, 3 and 4, supra).

Whether he had direct knowledge that his letters were likely to be used in an unlawful distribution has already been discussed (Part C-5, supra). Briefly, the Court has found that Homans had direct knowledge of the fact that his client was engaged in an illegal distribution of common stock upon conversion of the 6% debentures and for interest upon those debentures. His refusal to issue an opinion to Continental without the submission of a second opinion by Gedalecia in those instances points ineluctably to the conclusion that he knew that his opinion would be used to further those illegal distributions. As to the other distributions involved, it is clear that, had Homans exercised due diligence--had he made a thorough investigation of the representations being made to him--he would have known that the transactions upon which he was being asked to furnish an opinion for Continental also involved illegal distributions of unregistered securities. In view of the notice he had as of late 1967 or early 1968 as to the inherent problem of relying upon his client and Gedalecia, it was reckless for him not to have looked behind the representations before directing that Continental transfer the stock in question.

In concluding that Homans either knew or, under the circumstances, should have known that his acts--the rendering of

letters to Continental--would be used in the furtherance of illegal distributions, the Court would only add one point. The mere fact that Homans may not have been specifically retained as UMI's securities counsel and never received separate remuneration for his securities work after October 1967 does not relieve him of liability for failing to conduct the thorough investigation required by the Spectrum decision. In the appropriate case, the characterization of an attorney as "corporate" or "securities" counsel might be a factor in determining liability. The distinction is of no value where, as here, the facts show that the attorney under scrutiny participates in an illegal distribution to the substantial degree involved here, i.e., the writing of opinion letters.

E. Injunctive Relief

The S.E.C. has asked that an injunction be issued pursuant to Section 21(b) of the Securities Act, 15 U.S.C. § 77t(b), enjoining Homans from any further violations of Section 5. That this Court has the power to enjoin Homans from further violations involving any security--not just UMI securities--was resolved on an earlier occasion. S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1102-03 (2d Cir. 1972). There thus remains for determination the issue of whether an injunction prohibiting

Homans from violating Section 5 of the Securities Act in the future would be proper.

Injunctive relief under the Securities Act is governed by Section 21 (b), which provides in pertinent part:

"(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute ... a violation of the provisions of this subchapter, ... it may in its discretion, bring an action ... to enjoin such acts or practices, and upon a proper showing a permanent ... injunction ... shall be granted" (emphasis supplied).

Since Homans is no longer connected with UMI, the question before this Court is a narrow one: whether "there is a reasonable likelihood that the wrong will be repeated", S.E.C. v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1100; S.E.C. v. Management Dynamics, Inc., et al., supra, at 2340, and, where that likelihood has not been clearly demonstrated, whether injunctive relief would be appropriate under traditional equitable principles, remembering always that the public interest in S.E.C. enforcement proceedings is "paramount", S.E.C. v. Management Dynamics, Inc., et al., supra, at 2344 n. 5.

Whether a future violation is "a reasonable likelihood" depends upon the "totality of circumstances", including the fact that the defendant has been found liable for illegal conduct, id. at 2340; S.E.C. v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1100; the degree of scienter involved, S.E.C. v. Spectrum, Ltd., supra, 459 F.2d at 542; S.E.C. v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1100-01; whether the infraction is an "isolated occurrence", S.E.C. v. Management Dynamics Inc., et al., supra, at 2341; whether defendant continues to maintain that his past conduct was blameless, S.E.C. v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1101; and whether, because of his professional occupation, the defendant might be in a position where future violations could be anticipated, S.E.C. v. Management Dynamics, Inc., et al., supra, at 2341; S.E.C. v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1102.

Taking all of these considerations into account, the Court concludes that the S.E.C. has clearly established that there is a reasonable likelihood that defendant will commit the same or similar acts in the future. Although Homans will not have any opportunity to aid UMI management in the manner that he did in the past, his position as attorney for four other public corporations subject to the federal securities laws 35/ and

his expressed intention of continuing in the practice of securities law 36/ mean that he will be in a position to repeat the same kinds of, or similar, acts. Additionally, the acts for which defendant has been found liable here were carried out either with knowledge or reckless disregard of the truth. Furthermore, he has been found liable not merely for a breach of duty on an isolated occasion, but for a continuous breach of duty on numerous occasions, extending over a period of some five or six years. Homans' contention that his acts were "merely careless" and that, in view of the circumstances--his relationship with UMI management and the retention of Gedalecia--his acts were quite reasonable, as well as his "ignorance" 37/ of the most basic principles of the Securities Act, make it difficult for this Court to conclude that he now appreciates the lawyer's duties when rendering opinion letters, such that he would probably not repeat his mistakes.

The equitable considerations raised by defendant--most notably, the fact that he may now be subject to discipline under Rule 2(e) of the S.E.C.'s Rules of Practice, 17 C.F.R. § 201.2(e)--are clearly outweighed by the paramount interest of the public, particularly in view of the fact that his liability is predicated upon that most "essential" of activities; the preparation of opinion letters, S.E.C.v.

Spectrum, Ltd., supra, 489 F.2d at 542.

Accordingly, the Court shall issue an injunction against the defendant embodying the terms requested by the S.E.C. Submit order on ten (10) days notice.

Dated: New York, New York
July 11, 1975

CHARLES H. TENNEY
U.S.D.J.

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff

-against-
UNIVERSAL MAJOR INDUSTRIES CORP.,
et al.,

Defendants.

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FOOTNOTES

- 1/ The corporations named were Universal Major Industries Corp., Transamerican Petroleum Corp. and Banner Oil and Gas Funds, Inc. The four other individuals named were James G. Duncan, Roy M. Horsey, Ian McCartney and Edward J. Gedalecia.
- 2/ Universal Major Industries Corp., James G. Duncan, Roy M. Horsey and Ian McCartney.
- 3/ On November 13, 1973, the Court commenced an evidentiary hearing on the S.E.C.'s motion pursuant to Fed. R. Civ. P. 65 for a preliminary injunction against Homans. The hearings continued on November 14 and December 20, 1973, and February 15 and July 24, 1974. On the last of these dates, the Court granted the S.E.C.'s previously entered motion to consolidate the hearing with the trial on the merits pursuant to Fed. R. Civ. P.

65(a)(2).

- 4/ Brief in Support of Plaintiff's Proposed Findings of Fact and Conclusions of Law, pp.29-36.
- 5/ Homans used the phrase "private transaction" as a term of art. See Part C-3, infra. It is clear that, by employing that phrase, he intends to suggest that the transactions in question were ones which conformed to the "private offering" exemption of Section 4(2) of the Securities Act, see Part D-1, infra.
- 6/ Actually, UMI is the successor of Universal Major Corp., which from 1954 to 1966, was primarily engaged in the distribution of automotive and electronic products. In October 1966, that corporation merged with another corporation named Inland Resources Corp., and was renamed "Universal Major Industries Corp." During the relevant period, UMI was engaged principally in the exploration and development of oil and gas property interests.
- 7/ In August 1971, Gedalecia terminated his relationship with UMI and Emanuel Fields, not named as a defendant in this action, was retained in his place. Gedalecia was again retained for a brief period in April and May

FOOTNOTES - (Cont)
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1972.

- 8/ Additionally, the statement was amended in September 1971, after Fields, note 7 supra, became UMI's special securities counsel (Def. Exh. M). On July 25, 1972, Duncan requested that the S.E.C. withdraw its registration and the statement never became effective. (Transcript ["TR."] p. 479; Pl. Exh. 2).

<u>9/</u>	<u>Type of Transaction</u>	<u>Dates</u>	<u>No. of Shares</u>	<u>No. of(*) Transferees</u>
(1)	Issuances upon conversion of debentures	5/68-2/71	1,117,078	262
(2)	Issuances for interest on debentures in lieu of cash payment	8/69-6/71	266,580	489
(3)	Issuances for cash, property, or services	1/69-12/72	839,059	94
(4)	Transfers by Horsey	9/67-2/73 (**)	189,583	74
(5)	Transfers by Duncan and Transamerican	10/67-2/73 (**)	807,584	95

FOOTNOTES - (Cont)
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This information is drawn, from Pl. Exh. 1, which defendant repeatedly challenged as "distorted". In considering these figures (those portions of Exh. 1 which do not apply to Homans have been eliminated), two points must be kept in mind. First (*), the number of transferees does not necessarily reflect the number of different persons or entities which received UMI common stock. In other words, there may be some duplication. (Tr., p. 43). Second (**), although the sales of stock by Horsey, Duncan and Transamerican continued until February 15, 1973, it should be remembered that Homans terminated his relationship with UMI in January 1973. It seems probable, however, that the February 15, 1973 date merely represents the date when the actual sales were completed.

- 10/ Proof that there were uncompleted offers of UMI stock may only be inferred from circumstantial evidence introduced in the course of the trial. See, e.g. Tr., pp. 366-71.
- 11/ On three occasions in 1957, Nardone had purchased shares of Inland Resources Corp. (Def. Exh. A), the company which had merged in 1966 with Universal Major Corp. See note 6, supra.
- 12/ Approximately one year before he

FOOTNOTES-(Cont)

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purchased UMI common stock, Andersen had purchased a 1/64 participation interest in Banner Oil and Gas Funds, Inc., which was a wholly-owned subsidiary of UMI.

- 13/ It is important to note that much of Homans' testimony regarding the identify of transferees, their relationship to UMI, and the circumstances behind the transfers was apparently based upon information he obtained in preparation for defense of this suit. See, e.g., Tr., pp. 414-23.
- 14/ For example, he testified that, in one instance, he decided to invest in a concern on the basis of the number of cars in the company parking lot on the theory that the more cars that were there, the higher the company's profits. Tr., pp.69-71.
- 15/ Tr., p. 82.
- 16/ Tr., p. 84.
- 17/ Tr., pp. 54-55
- 18/ Tr., p. 126.
- 19/ Tr., p. 128.

FOOTNOTES-(Cont)

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- 20/ Tr., pp. 425-26, 432, 464.
- 21/ See Pl. Exh. 13, which Homans testified was prepared by Gedalecia.
- 22/ Tr., pp. 340, 341, 425-26.
- 23/ Exh. 9A
- 24/ Tr., pp. 394-95, 466.
- 25/ Tr., p. 450.
- 26/ Tr., p. 364.
- 27/ See, e.g., S.E.C. v. North American Research & Development Corp., 424 F.2d 63, 71-72 (2d Cir. 1970); Gilligan, Will & Co. v. S.E.C., 267 F.2d 461, 466 (2d Cir. 1959). These decisions support the conclusion, contrary to defendant's contention, that the burden of proof in establishing the applicability of an exemption is on the party claiming the benefit of the exemption, whether or not that party is the issuer.
- 28/ Although the complaint also alleges violations of Section 5(c), which makes it unlawful to offer to sell securities unless a registration statement has been filed, the proof on this issue was not made

out be a preponderance of the evidence. The dearth of evidence offered by the S.E.C. to establish when and under what circumstances such offers were made, note 10 supra, together with the fact that UMI filed a registration statement at one point during the relevant period, note 8 supra, make it difficult for the Court to state on the basis of the evidence offered that there was a violation of Section 5(c).

29/ Section 3(a)(9) exempts from registration:

"Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange."

That section was invoked by Gedalecia in reference to the issuances of common stock in lieu of cash interest payments and Homans sent to Continental Form-1 letters which indicated reliance upon that conclusion. Whether Section 3(a)(9) was intended to cover those transactions, as well as the transactions in which common stock was issued upon

conversion of debentures which themselves had never been registered, need not be addressed since Homans has offered no statutory or decisional support for reliance upon that section. See Post-Trial Reply Memorandum of Defendant Arthur J. Homans, pp. 26-30.

Section 4(1), which exempts from registration "transactions by any person other than an issuer, underwriter, or dealer", was cited by Homans in Form-2 letters as the basis for an exemption for transactions in which Horsey, Duncan and Transamerican transferred their stock to others. Although defendant argues that the S.E.C. failed to prove that the three were statutory underwriters, as defined in Section 2(11) of the Act, 15 U.S.C. § 77b(11), Post-Trial Reply Memorandum of Defendant Arthur J. Homans, pp.21-25, he had the burden of proof on this issue, note 27 supra, a burden which he failed to meet.

30/ The question of whether securities are part of the same "issue", a matter which defendant briefs rather extensively, arises in the context of Section 3(a)(11), the "intrastate exemption", and not, as will be seen from the discussion in the text, infra, when determining whether an

FOOTNOTES-(Cont)
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exemption pursuant to Section 4(2) is available.

- 31/ The question as to whether Section 4(2) exempts from the registration requirements stock transferred under circumstances in which the issuer does not solicit such transfers was apparently raised and rejected in S.E.C. v. Ralston Purina Co., 346 U.S. 119, 121, 125 (1953). Moreover, it strains credulity to believe that the hundreds of transferees involved in this case would have independently "solicited" UMI common stock in exchange for their fractional interests in oil and gas properties, in lieu of cash payment on their debentures, or in payment for services rendered for UMI. It is more probable that, since UMI was suffering from a cash shortage (Tr., p. 280; Def. Exh. M), it initiated the transactions by "suggesting" that transferees accept common stock instead of cash.
- 32/ See, e.g., the partial record provided by Homans. (Tr., pp. 294-319, 380-382 and Def. Exhs. J, N.).
- 33/ See S.E.C. v. Continental Tobacco Co. of S.C., 463 F.2d 137, 158, (5th Cir. 1972).
- 34/ The injunctive relief which the S.E.C.

FOOTNOTES-(Cont)
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requests virtually tracks the language of Section 5 of the Securities Act. See Complaint, pp. 8-9.

- 35/ Tr., pp. 372-76.
- 36/ Tr., p. 479.
- 37/ Tr., p. 438.

APPENDIX C

**ORDER DENYING PETITION FOR REHEARING
(DATED MARCH 25, 1977)**

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twenty-fifth day of March, one thousand nine hundred and seventy-seven

Present: HON. J. EDWARD LUMBARD

HON. ELLSWORTH A. VANGRAAFEILAND,
Circuit Judges.

HON. DUDLEY B. BONSAI,
District Judge

SECURITIES & EXCHANGE COMMISSION,	:
Plaintiff-Appellee,	:
v.	:
Universal Major Industries Corporation	:
James G. Duncan, Transamerican Petroleum	:
Corporation, Roy M. Horsey, Banner Oil	:
& Gas Funds, Inc., Ian McCartney, Arthur	:
J. Homans & Edward G. Gedalecia,	:
Defendants,	:
Arthur J. Homans,	:
Defendant-Appellant	:

75-6111

A petition for a rehearing having

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been filed herein by counsel for the
defendant-appellant

Upon consideration thereof, it is

Ordered that said petition be and
hereby is DENIED.

A. DANIEL FUSARO
Clerk

APPENDIX D
STATUTES INVOLVED

Securities Act of 1933

Section 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly-

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

Section 20. (b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be

granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this title. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of began or in the district wherein such prospectus or security is received